ISSUES PAPER : CREDIT CO-OPERATIVES WORKSHOP
9 NOVEMBER 1991

The following paper is provided as a background to the workshop and to raise discussion on issues regarding the provision of low cost loans and improving the access to credit for all members of the community.

1. Background

The aim of the workshop is to address the current situation regarding the provision of low cost loans and, if required, consider mechanisms which could assist credit co-operatives to provide such services.

In 1986 the Ministry of Consumer Affairs launched the Community Credit Program to improve the access of low income people to affordable credit. Five community agencies in the inner Melbourne area, including two credit co-operatives, received funding to provide low cost loans to people on low incomes.

Under the Social Justice Strategy the Low Cost Loans Program provided access to credit for low income people who were not serviced by mainstream bank financial institutions.

A low cost loan is a loan which is provided at a lower rate relative to other loans available on the market. Therefore the lower the cost of the loan and interest rate the greater the access to that loan.

Funding has been provided up until June 1992, however the future of the program after that date is unclear.

2. Credit Co-operatives

There are 105 credit co-operatives registered in Victoria with over 578,000 members, as at 30 june 1991. Credit co-operatives are non profit financial institutions which operate on a democratic basis and promote the economic and social well being of their members. They are organized for and by a group of people with a common interest who have joined together to provide themselves with a convenient place to save and in turn lend to each other from those savings at the lowest practicable rates of interest, and to obtain other financial services. Credit co-operatives, like any other financial institution, need a mixture of savers and borrowers within their membership in order to be viable. A further objective is to encourage their members in habits of thrift.

The objective is that profits are returned to members in the form of low cost loans, high interest rates on savings and investment accounts and in the provision of many free services.

Historically, credit unions were established with the aim of solving the fundamental problems of scarcity of credit and exorbitant interest rates and thus achieve financial independence for members.

The basic principles and philosophies of the early pioneers of the credit union movement were to provide a service to those people with the greatest needs - those too poor to pay high interest rates on loans and the working classes who were at the mercy of financial profiteers.

3. Community Credit Program

During the period January 1989 - March 1990 619 loans were provided through the Community Credit Program to 414 pensioners and beneficiaries for a total amount of $514000. The average size of a loan was $830 and they were used largely to purchase essential household items. Interest rates charged ranged between 0% and 10%.

Funding for the administration of loans in 1990/91 has been as follows :

Fitzroy & Carlton Community Credit Co-operative
$32,000

Macaulay Community Credit Co-operative
$20,000

Good Shepherd Youth & Family Services
$16,000

Hanover Welfare Services
Nil

West Heidelberg Community Health & Welfare Centre
$16,000

The two credit co-operatives provided 79% of the loans of the program. The incidence of significant arrears problems in the program appears to be very low, with the default rate for loans provided by Fitzroy and Carlton Community Credit Co-operative and Hanover Welfare Services being approximately 8.5%. This related to borrowers who were in arrears of more than 32 days at the end of March 1990. It should be noted that all financial institutions are currently experiencing high default rates. The average default rate for credit co-operatives was 3.7 % at June 1991, with bank financial institutions averaging approximately 8%.

The Brotherhood of St. Laurence undertook an independent evaluation of the Low Cost Loans Program, "Credit to the Community", which concluded that low cost lending agencies are successfully servicing low income people who have no access to mainstream lenders or who are so intimidated by mainstream lending practices that they feel they have no access. The study

suggested that there is emerging evidence that mainstream banks may be reducing services through the introduction of fees on small transactions and adopting a user pays principle in the provision of services to low balance depositors.

The Brotherhood study concluded that community credit co-operatives are emerging as suitable models for the design of partnership projects providing affordable and consumer oriented credit services. They offer a range of financial services to their members and operate within a regulatory framework, whilst maintaining close links to a range of consumer support services.

The study also proposed that low cost lending services could be established on a statewide basis subject to further work on the feasibility of extending the services beyond the inner Melbourne area, and identification of potential sources of capital funding.

The workshop is aimed at identifying whether such services are currently being provided by credit co-operatives, and if not, or if not adequately, consider options whereby credit co-operatives would be able to provide such services with or without the support of government funding. A further aim will be to examine mechanisms by which to achieve this.

4. Credit Union Operating Principles

Worldwide credit co-operatives operate according to an International set of Principles of relevance to this discussion are the following :

Open membership
Membership in a credit union is voluntary and open to all within the accepted common bond of association that can make use of its services and are willing to accept the corresponding responsibilities.

While many low income people could afford to join a credit union, the possibility of obtaining a loan may be limited by a number of factors.

Firstly, the size of the loan required and the cost of administering that loan. A spokesperson for the Australian Bankers Association confirmed that it is not economical for banks to provide personal loans for less than $2000 because of the cost of interviewing and administering such a scheme. Can credit co-operatives provide such services and remain viable? What is the actual and/or perceived capacity to effectively and efficiently administer these loans?

Secondly, the actual and/or perceived capacity of the borrower to repay the loan. The perception that people on low incomes are high risk borrowers remains. However the Brotherhood study concluded that people on low incomes posed no greater default risk than did customers of mainstream bank financial

institutions. Further, many credit unions provide more than just access to credit - it is an integrated approach providing budget advice, bill paying services and referral to financial counseling.

Are there individuals and groups who are unjustly excluded from credit union membership and applying for and receiving loans? Does this vary and depend on the common bond of credit co-operatives and their development phase?

Co-operation between Co-operatives
In keeping with their philosophy and the pooling practices of co-operatives, credit unions within their capability actively co-operate with other credit unions, co-operatives and their associations at local, nation and international levels in order to best serve the interests of their members and their communities.

There is an explicit expectation that co-operatives should assist other co-operatives. What are the possibilities for individual credit co-operatives facilitating the development of other credit co-operatives while not compromising their own viability ?

To what extent should co-operation between co-operatives be maintained and developed through credit co-operative associations? Should the common bond of existing credit co-operative be negotiated if there is an existing and/or potential membership which could be better served by a new co-operative?

Social Justice
Continuing the ideals and beliefs of co-operative pioneers, credit unions seek to bring about human and social development. Their vision of social justice extends both to the individual members and to the larger community in which they work and reside. The credit union ideal is to extend service to all who need and can use it. Every person is either a member or a potential member and appropriately part of the credit union sphere of interest and concern. Decisions should be taken with full regard for the interest of the broader community within which the credit union and its members reside.

This principle suggests that credit union membership should be open to the 'unbanked' - those people who do not have accounts with bank financial institutions. People who have low incomes need and can use credit unions and are therefore part of the sphere of interest and concern. The onus on credit co-operatives therefore is to reconcile the principle of social responsibility with the principle of building financial stability. A prime concern of credit co-operatives is to build financial strength, including adequate reserves and internal controls that will ensure continued service to membership.

5. Issues

The rate charged and the availability of loans is determined by the cost of administering that loan, and any risk factors associated with that loan. What are the costs inherent in providing or administering loans ? Which credit unions currently are able to provide low rates on loans? Has this been achieved because the credit co-operative is large and can therefore achieve economies of scale, or the credit co-operative is so localized it can utilize voluntary labour? What are the constraints - statutory and prudential - to the provision of such loans ?

Secondly, should one client segment of a credit union be provided with a different rate of interest or borrowing to other client segments, or is the purpose to provide low cost loans to all?

Thirdly, is it desirable to encourage the borrowing of funds rather than promote saving, and what assessment criteria would be used regarding these loans ?

6. Proposals

There are several proposals regarding the provision of low cost loans worthy of exploration.

Firstly, assistance by the larger credit co-operatives to the smaller co-operatives, thus combining the principle of co-operation between co-operatives and the principle of social responsibility. This could be achieved through the development of a fund, whereby money would be available to pay for the administration costs of a low cost loans program. The assessment of loans would still be undertaken by the individual credit co-operatives and loan applicants would be assessed in terms of the members ability to repay and in accordance with the prudential standards of the credit co-operative.

Secondly, individual credit co-operatives could establish directed deposit accounts which would provide lower returns, with the additional interest earned being used to provide personal loans at lower interest rate for low income people.

Examination of these proposals raises a number of questions :

- Are credit unions already meeting this need and providing loans to low income people and providing low cost loans at a lower than market rate?

- Is it appropriate to place funds belonging to the members of one credit co-operative for use of members of another credit co-operative? Is this legally achievable or would it have to be in the form of a donation etc. ?

- What is the access of people on low incomes to credit co-operatives and how can this access be improved ?

- What current policies and practices of credit unions include/exclude people who have low incomes?

- What are the necessary conditions for credit unions expanding services to people who have low incomes?

- Is saving for such a loan amount a feasible alternative to credit? Does it contravene the credit union objective of encouraging thrift to provide a loan rather than assistance and financial counseling to save?

- Who would monitor the use of directed deposits to ensure that the funds are only provided to low income people ?

- How can the social responsibility of credit unions to people with low incomes remain consistent with the financial stability of co-operatives?

- How can such a program be achieved in a prudent and financially sensible manner ?

Marg Warner
Co-operative Development Unit
November 1991